No. 18506

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

R. A. RIDDELL, District Director of Internal Revenue, Los Angeles District,

Appellant,

vs.

CALIFORNIA PORTLAND CEMENT COMPANY, a corporation,

Appellee.

On Appeal From the Judgment of the United States District Court for the Southern District of California.

BRIEF OF APPELLEE, CALIFORNIA PORTLAND CEMENT COMPANY.

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TOPICAL INDEX

INDEX TO APPENDICES

TABLE OF AUTHORITIES CITED

Cases Page

Miscellaneous

Rules and Regulations

Statutes Page

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BRIEF OF APPELLEE, CALIFORNIA PORTLAND CEMENT COMPANY.

I.

JURISDICTION.

This civil action for the refund of internal revenue taxes (corporation income and excess profits taxes) was duly commenced in the District Court for the Southern District of California, Central Division, under Sections 1331(a) and 1340 of Title 28 of the United States Code, as amended. Following the first trial of this action, the final decision and judgment of the District Court was entered on November 21, 1958. Timely cross-appeals were then taken to this Court. On February 12, 1962 this Court entered its judgment reversing such decision in part and remanding this action to the District Court for further proceedings. Follow-

ing a second trial on remand, the District Court entered its final decision and judgment on October 8, 1962. A timely appeal was then taken to this Court; and the jurisdiction of this Court rests upon Section 1291 of Title 28 of the United States Code, as amended.

II.

STATUTE AND REGULATIONS INVOLVED.

The pertinent statutory provisions and Treasury Regulations are reproduced in Appendices A and B.

III.

STATEMENT OF THE CASE.

California Portland Cement Company, a corporation with its principal place of business at Los Angeles, California (hereinafter referred to as "appellee"), was engaged during the taxable years in question in extracting calcium carbonate rock from its Colton Quarry and Slover Mountain deposit and processing such raw material to obtain finished cement (Portland cement and allied types) which it sold. Appellee also obtained and sold small quantities of various by-products from a portion of such calcium carbonate rock as an incident to the principal operation.[1] The major portion of such cement and by-products was sold in bulk; the balance was sacked prior to sale.

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[1]Such by-products were as follows:

(a) *Crushed and screened calcium carbonate rock* (fluxstone) sold to Kaiser Steel Corporation for use as blast furnace flux.

(b) *Ground calcium carbonate rock* sold for use as glass sand, poultry grits, roofing grits, and clay pigeon filler (dust.)

(c) Waste fines sold for use as *paving dust.*

(d) *Finished lime products* (quicklime and hydrated lime) sold for use as such.

(e) *Cement clinker* sold to Blue Diamond Corporation, which then ground this purchased clinker with gypsum in its own finish grinding mill to produce finished cement.

This is an appeal in a civil action, duly commenced in the District Court for refund of a portion of the corporation income and excess profits tax for the taxable years ended April 30, 1951, and April 30, 1952, assessed against and collected from appellee by R. A. Riddell, District Director of Internal Revenue, Los Angeles District (hereinafter referred to as "appellant"). The refund suit arises out of a dispute over the dollar amounts of the percentage depletion allowances to which appellee was and is entitled for such taxable years by reason of the depletion of such calcium carbonate rock deposit in which it has an economic interest.

Effective with respect to the period here involved Section 114(b)(4) of the Internal Revenue Code of 1939, as amended, provided for percentage depletion allowances for "calcium carbonates" at the rate of 10% of the taxpayer's "gross income from the property" and "gross income from mining."[2] The term "mining" is defined by the statute to include not merely the extraction of the mineral from the ground, but also the ordinary treatment processes normally applied by mine owners and operators in order to obtain the commercially marketable mineral product or products. As a consequence of the enactment of the Public Debt and Tax Rate Extension Act of 1960, Section 302(b),[3] the depletion statute further provides that "in the case of calcium carbonates and other minerals when used in

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[2]The issue as to whether the appellee's calcium carbonate rock is instead to be treated as "chemical grade limestone," depletable at a 15% rate, or as "marble," depletable at a 5% rate, is no longer present in this proceeding. Both parties are now in agreement that the 10% "calcium carbonates" rate is applicable here.

[3]86th Congress, 2nd Session; 74 Stat. 290, 292.

making cement" the "ordinary treatment processes" to be considered part of "mining" shall encompass "all processes (other than preheating of the kiln feed) applied prior to the introduction of the kiln feed into the kiln, but not including any subsequent process."[4]

The points at issue below involved the dollar amount of the gross income base to which the 10% "calcium carbonates" rate is to be applied in computing appellee's depletion allowances.

The history of this cause and the nature of the questions now presented on appeal are as follows:

(a) The First Trial and the First Appeal.

At the time of the first trial of this action in October of 1958, the Courts had held virtually without exception that no distinction is to be made between "mining" and "manufacturing" for purposes of the depletion statute and that the provisions of Section 29.23(m)-1(e)(3) of Treasury Regulations 111 (and the corresponding provisions of Treasury Regulations 118, Section 39.23(m)-1(e)(3)) were invalid and ineffective if and to the extent that they purported to limit the application of the percentage depletion allowance to gross income less than the total gross income derived by the taxpayer from the sale of the marketable

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[4]Section 613(c)(4)(F) of the Internal Revenue Code of 1954, as amended (26 U.S.C.). This provision was made effective with respect to the taxable years here at issue by Public Law 86-781, (86th Congress, 2nd Session; 74 Stat. 1017, 1018). In the course of the second trial Public Law 86-781 was erroneously referred to by counsel for both parties as "Public Law 86-564." The latter designation properly refers to the Public Debt and Tax Rate Extension Act of 1960. Accordingly, wherever "Public Law 86-564" appears in the Printed Transcript of Record and the pre-trial memoranda [Exs. 30 and 31], it should be read as "Public Law 86-781."

products actually obtained from its mine or quarry. In these cases the Courts had held that the applicable "gross income from the property" and "gross income from mining" to which the percentage rate is to be applied was the taxpayer's gross receipts from the sale of such diverse finished end-products as cement,[5] lime,[6] brick and tile,[7] vitrified sewer pipe,[8] and talc crayons.[9] These holdings were based on the premise that the taxpayer is entitled to process its mineral raw material until it is in a form for which a commercial market exists in terms of the quantities actually produced by the taxpayer and that all such processing qualifies as "mining" in such event. As a concomitant, the Courts established the principle that sales of by-products in the form of crude or semi-finished products at various stages of processing, for which only limited markets exist, do not establish a representative field or market price or "cut-off point" to be applied to the

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[5]*Dragon Cement Company, Inc. v. United States,* 244 F. 2d 513 (1st Cir., 1957), *cert. den.* 355 U. S. 833 (1957); *Monolith Portland Cement Company v. United States,* 168 Fed. Supp. 692 (S.D. Calif., 1958), *aff'd.* 269 F. 2d 629 (9th Cir., 1959); and *Riverside Cement Company v. United States,* ..... Fed. Supp. ..... (58-2 USTC, par. 9905) (S.D. Calif., 1958).

[6]*Riverton Lime and Stone Company v. Commissioner,* 28 T.C. 446 (1957).

[7]*Cherokee Brick and Tile Company v. United States,* 218 F. 2d 424 (5th Cir., 1955); *Merry Brothers Brick and Tile Company v. United States,* 242 F. 2d 708 (5th Cir., 1957), *cert. den.* 355 U.S. 824 (1957); and *Sapulpa Brick and Tile Corporation v. United States,* 239 F. 2d 694 (10th Cir., 1956).

[8]*Cannelton Sewer Pipe Co. v. United States,* ..... Fed. Supp. ..... (58-2 USTC, par. 9676) (S.D. Ind., 1958), *aff'd.* 268 F. 2d 334 (7th Cir., 1959); *Pacific Clay Products Company v. United States,* ....Fed. Supp. ..... (59-1 USTC, par. 9252) (S.D. Calif., 1958); and *Richland Shale Products Co. v. United States,* 168 Fed. Supp. 731 (N.D. Ohio, 1958).

[9]*The Hitchcock Corporation v. Townsend,* 132 Fed. Supp. 758 (N.D., N.C., 1955), *aff'd.* 232 F. 2d 444 (4th Cir., 1956).

balance of mineral production, which must be further processed in order to be "commercially marketable."

Consistent with the then prevailing weight of authority, the District Court held at the first trial that appellee's "gross income from mining" was its gross income during each taxable year involved derived from its sales of finished cement together with its sales of by-products, in bulk and in sacks, F.O.B. mill (after deduction of returns and allowances), including the 40 cents per barrel additional income for that portion of its finished cement sold in sacks and any additional income attributable to having sold a portion of its other products in sacks, and without any deduction on account of cash discounts allowed by appellee or on account of the "additives used by appellee in producing its cement clinker and finished cement.[10] The 10% "calcium carbonates" rate was then applied to the gross income so derived to determine the amount of the depletion allowances to which appellee was entitled, and judgment was entered for appellee in the amount of $1,073,612.46.

On January 20, 1959, the appellant filed a Notice of Appeal to this Court from the decision of the District Court, and later the same day appellee filed its Notice of Cross-Appeal.[11] Appellee's cross-appeal was filed

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[10]F. of F. No. 26 and 27 and C. of L. No. 7, 8, 9 and 10 [R. 143-144, 147-148] in Case No. 16438 on appeal to this Court. By stipulation of the parties, the printed Transcript of Record in Case No. 16438 has been made a portion of the materials before this Court on this appeal even though not reprinted in the Transcript of Record in Case No. 18506 [R. 172]. For ease in citation, the printed transcript in Case No. 16438 will be referred to hereafter as "First Record," and the printed transcript in Case No. 18506 will be referred to as "Second Record."

[11]First Record, 156-158.

for protective purposes and was limited to the question of whether its calcium carbonate rock constituted "chemical grade limestone" entitled to depletion at the 15% rate provided in Section 114(b)(4)(A)(iii) of the Internal Revenue Code of 1939.[12] Appellant's appeal raised four basic issues as follows:[13]

(1) Whether the 5% "marble" rate should be applied under Section 114(b)(4)(A)(i) rather than the 10% "calcium carbonates" rate held applicable by the District Court under Section 114(b)(4)(A)(ii).

(2) Whether the District Court erred in holding that appellee's depletion base was the gross income from sales of its finished products "rather than on the basis of gross income from crushed stone or, in the alternative, cement clinker."

(3) Whether the District Court erred in including in appellee's depletion base "income attributable to certain materials added to the taxpayer's stone in the course of the production of cement and cement clinker."

(4) Whether the District Court erred in including in appellee's depletion base "income attributable to the sacks in which it sold portions of its cement and other products and income attributable to the process of sacking."

The appellant did not appeal from the District Court's finding that the discounts which appellee allowed to its customers, after sale, were "cash discounts" rather than "trade discounts" or the holding that appellee was not required to deduct such discounts from its "gross income from the property" and "gross income

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[12]Statement of Points on Appeal [First Record 783-785].

[13]Statement of Points on Appeal [First Record 786-787].

from mining" in computing the percentage depletion allowances to which it was entitled.[14]

The cause was briefed before this Court on these issues, and oral argument was held on June 10, 1960. Subsequently, on June 27, 1960, the United States Supreme Court entered its decision in *United States v. Cannelton Sewer Pipe Company,* 364 U.S. 76. This Court then granted the parties leave to file supplemental briefs directed to the effect of the Supreme Court's decision in the *Cannelton* case with respect to the issues on appeal. Monolith Portland Cement Company was also permitted to file a brief *amicus curiae* at that time.

After consideration of these briefs, this Court issued its first opinion in this action on October 5, 1961. Monolith Portland Cement Company, as *amicus curiae,* then objected to certain portions of this first opinion and requested reconsideration of those aspects of the case. This was granted; and on January 2, 1962, this Court withdrew its first opinion and issued a new opinion, which is reported at 297 F. 2d 345. Neither party petitioned for the issuance of a writ of *certiorari.* The judgment of this Court was entered on February 12, 1962, pursuant to its Rule 26, and the cause was then remanded to the District Court for further proceedings.

(b) The Decision of This Court on the First Appeal.

Two events of significance occurred subsequent to the entry of judgment in this case by the District Court on November 21, 1958, following the first trial, and

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[14]F. of F. No. 14 and 26, and C. of L. No. 9 [First Record 143-144, 147-148].

prior to the issuance of the opinion of this Court on January 2, 1962. The first, as noted earlier, was the decision of the Supreme Court on June 27, 1960, in the *Cannelton* case, which involved the computation of percentage depletion allowances for fire clay and shale used in the production of sewer pipe.

The second (and more important) was the enactment of Public Law 86-781 which provides that, at the election of the taxpayer, the provisions of Section 302(b) of the Public Debt and Tax Rate Extension Act of 1960 would be applied retroactively in determining its percentage depletion allowances for all taxable years not then barred by the applicable statute of limitations.[15] Section 302(b) provides that, in the case of calcium carbonates and other minerals when used in the making of cement, the statutory term "mining" specifically includes "all processes (other than preheating of the kiln feed) applied prior to the introduction of the kiln feed into the kiln, but not including any subsequent process." By this provision, Congress adopted the kiln-feed cut-off point for cement production first established by the Internal Revenue Service ten years ago upon the publication of Revenue Ruling 290, 1953-2 C.B. 41.[16]

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[15]The pertinent provisions of Public Law 86-781 and the Public Debt and Tax Rate Extension Act of 1960 are set forth in Appendix "A" hereto for the convenience of the Court.

[16]Revenue Ruling 290 stated in part:

> "It is the position of the Internal Revenue Service that calcium carbonates and shale, mined for use in the cement industry, are not customarily sold in the form of the crude mineral product, and that, therefore, under section 39.23(m)-(1)(f) of regulations 118, crushing and grinding are considered 'ordinary treatment processes' in the computation of gross income from the property for percentage depletion purposes."

On November 7, 1960, appellee duly filed a timely election in the manner specified in Treasury Regulations §1.9003-4 to have the provisions of Section 302(b) apply to the computation of its percentage depletion allowances for calcium carbonates and other minerals used in making cement with respect to all open taxable periods, including the taxable years ended April 30, 1951, and April 30, 1952, here at issue.[17] This Court was notified of the fact of such election by appellee on November 23, 1960.

When the appellee filed its supplemental brief with this Court on appeal, it was anticipated that the President would soon sign Public Law 86-781 (which had then been passed by both Houses of Congress and was awaiting signature) and that appellee would thereafter make this election. Therefore, appellee made certain concessions in light of the *Cannelton* decision and this new legislation and advised this Court that, accordingly, its percentage depletion allowances with respect to its calcium carbonate rock used in the production of cement, cement clinker, and lime should be computed by reference to a kiln-feed cut-off point rather than on the end-product basis previously asserted. In its supplemental brief, appellee made the following statement as to its position in this regard:[18]

> "Based on the record and the concessions made by appellee herein, and for the reasons developed in this brief, appellee submits that this action should be remanded to the District Court with in-

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[17]F. of F. No. 23 [Second Record, 16]; Second Record 71-72.

[18]Supplemental Brief of Appellee, California Portland Cement Company, filed in Case No. 16438, Pp. 50-51.

structions that appellee's 'gross income from the property' for percentage depletion purposes is to be recomputed in accordance with the following principles:

"1. Appellee's 'gross income from the property' with respect to the tonnage of its mineral sold in the form of crushed and screened calcium carbonate rock (fluxstone) should be computed on the basis of the selling prices for such material.

"2. Appellee's 'gross income from the property' with respect to the tonnage of its mineral sold in the form of waste fines (paving dust) should be computed on the basis of the selling prices for such material.

"3. Appellee's 'gross income from the property' with respect to the tonnage of its mineral sold in the form of ground calcium carbonate rock or the form of finished lime products should be computed on the basis of the selling prices for such ground calcium carbonate rock.

"4. Appellee's 'gross income from the property' with respect to the tonnage of its mineral sold in the form of cement clinker or the form of finished cement should be computed by the proportionate costs and profits method on the basis of a kiln-feed cut-off point.

"5. No deduction should be made from appellee's 'gross income from the property' on account of the cash discounts allowed to purchasers of its products or on account of 'additives' used in the production of cement clinker and finished cement prior to the kiln-feed cut-off point.

"6. Both any additional income attributable to selling a portion of its products in sacks rather than in bulk and the costs incurred in such sacking operation should be excluded from the computation of appellee's 'gross income from the property.'

"For the reasons stated in appellee's main brief, it is submitted that the District Court's Findings of Fact and Conclusions of Law with respect to the 'marble' issue should not be modified or set aside. Accordingly, on remand, the District Court should be instructed to apply the 10% 'calcium carbonates' rate to appellee's gross income from the property' as so recomputed in determining the percentage depletion allowances to which appellee is entitled for the taxable years ended April 30, 1951, and April 30, 1952."

It appears clear that such statement of appellee's position was a major factor in the form of the decision on appeal. Referring to this election subsequently made with respect to minerals used in the production of cement (including clinker), this Court stated: "That renders a determination of the proper cut-off point moot in this case." (297 F. 2d 345, 355). This Court then remanded the cause to the District Court for further proceedings with instructions for it to compute the depletion base in light of the kiln-feed cut-off election made by appellee and to apply 10% "calcium carbonates " rate.

(c) The Second Trial.

The decision of this Court established with finality that the 10% "calcium carbonates" rate is to be applied to all of the mineral which appellee extracted from its Colton Quarry and Slover Mountain deposit in comput-

ing its percentage depletion allowances for the taxable years concerned,[19] and the only question remaining for determination by the District Court on remand was the dollar amount of the "gross income from the property" base to which such percentage rate is to be applied.

As respects the portion of appellee's calcium carbonate rock which was processed into cement clinker and finished cement, the parties were in complete agreement as to the point where "mining" ends: the cut-off point is at the kiln-feed stage, after crushing, grinding, and blending and immediately prior to introduction of the raw mix into the kiln. It was further agreed that such computation is to be made by application of the basic proportionate costs and profits or "rollback" formula provided in Treasury Regulations 111, Section 29.23(m)-1(e)(3).[20]

Following a stipulation that the grinding involved did not exceed the sizing limitations set forth in Revenue Ruling 62-5 (1962-3 IRB, p. 7), the parties agreed that a kiln-feed cut-off point and such proportionate costs and profits formula were also to be applied in computing the "gross income from the property" in the case of appellee's lime plant operations, where hand-selected high purity calcium carbonate rock was processed into ground calcium carbonate rock and finished

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[19]Exhibit 31 [Defendant's Pre-Trial Memorandum], footnote 1 on p. 1.

[20]Second Record 50-51; Exhibit 31 [Defendant's Pre-Trial Memorandum], pp. 2-4; Exhibit 30 [Plaintiff's Pre-Trial Memorandum], pp. 8-9. A description of the processes applied by appellee to produce clinker and cement is contained in Paragraph 3(c) of the Pre-Trial Conference Order [First Record 72-73].

lime products.[21] It was tacitly understood by all concerned at the second trial that, in the case of the portions of appellee's mineral production sold in the form of crushed and screened calcium carbonate rock (fluxstone) and waste fines (paving dust), the actual prices for which these by-products were sold would be used as the depletion base.[22]

Accordingly, the District Court's role at the second trial was limited to determining the manner in which "additives," "sacking," and "discounts" are to be handled under the proportionate costs and profits formula by reference to a cut-off at the kiln-feed point in determining appellee's "gross income from the property." Following a hearing on the merits and oral argument, the trial judge ruled on these points as follows:

(1) All of the processes applied by appellee to its calcium carbonate rock prior to the kiln-feed point (including the addition of iron ore and quartzite in the raw grinding stage in the production of cement clinker and cement) were "ordinary treatment processes normally applied by mine owners and operators" and "mining" within the meaning of Section 114(b)(4) of the Internal Revenue Code of 1939, as amended. Appellee's sacking of a portion of the products produced from its calcium carbonate rock was not such an ordinary treatment process [C. of L. No. 6; Second Record 20].

(2) Appellee is not required to deduct from its "gross income from mining" any amount on account

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[21]Second Record 70-71; Exhibit 31, pp. 3-4; Exhibit 30, pp. 8-9. Paragraphs 3(f) and 3(i) of the Pre-Trial Conference Order [First Record 74-76] describe the processes applied by appellee in obtaining these products in its lime plant.

[22]Paragraphs 3(k) and 3(t) of the Pre-Trial Conference Order [First Record 77-78, 82] set forth the particulars as to fluxstone and paving dust.

of the discounts allowed purchasers of its finished cement, paving dust, and ground calcium carbonate rock or any amount on account of the "additives" used in producing its cement clinker and finished cement [C. of L. No. 7; Second Record 20-21].

(3) Both the additional income attributable to appellee's selling a portion of its products in sacks rather than in bulk and the additional costs incurred as a consequence of selling such portion in sacks rather than in bulk are to be excluded in the computation of appellee's percentage depletion allowances [F. of F. No. 28; Second Record 17].

The District Court then computed the amount of the depletion allowances to which appellee was entitled on such a basis and, following denial of appellant's motion for a new trial, entered judgment for appellee in the amount of $74,428.00.[23] With only the most minor of differences, such rulings by the District Court followed the method of computation asserted by appellee in its supplemental brief in the prior proceeding before this Court as quoted above.

(d) The Appeal of R. A. Riddell.

At the trial the appellant took issue with the manner of handling cash discounts and the income and expense involved in sacking operations under the proportionate costs and profits formula sought by appellee, but the District Court ruled for appellee on both points.[24]

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[23]Second Record 22, 37, 43-44. The schedules appearing at pp. 23-36 of the Second Record set forth the details of the computation of such depletion allowances and the resultant refunds of income and excess profits taxes.

[24]*Discounts:* F. of F. No. 13 and 29 [Second Record 12, 18]; C. of L. No. 7 [Second Record 20-21]; Second Record 62-70, 158-159.

In its Statement of Points on appeal, the appellant did not mention the "sacking" and "discount" issues and instead limited its appeal to this Court as follows [Second Record 171]:

> "1. The District Court erred in holding that, in computing taxpayer's income from mining (its percentage depletion base) by the proportionate profits method prescribed in the pertinent Treasury Regulations, for the limestone taxpayer mined and used to make cement and cement clinker, the costs of iron ore and quartzite added to the limestone are to be treated as mining costs."

Appellant's opening brief in this proceeding confirms that the appeal is limited to the pre-kiln "additives" question and that the "sacking" and "discounts" points are no longer at issue.[25]

Sacking: F. of F. No. 28 and 29 [Second Record 17-18]; C. of L. No. 6 [Second Record 20]; Second Record 52-54, 72-75, 159-167.

[25]Appellant's Brief, Pp. 4, 9, 13, and 18. As a consequence of appellant's failure to appeal with respect to these latter points, the decision of the District Court as to the manner in which "sacking" and "discounts" are to be handled under the proportionate costs and profits formula is to be treated as having become final. This means that appellee will be entitled to a portion of the refunds found due by the court below in all events, regardless of this Court's decision on the "additives" issue.

IV.
ARGUMENT.

A. The Trial Court Was Correct in Holding That the Additions of Iron Ore and Quartzite in the Raw Grinding Stage in the Production of Cement Clinker and Cement Were "Ordinary Treatment Processes" and "Mining" Within the Meaning of Section 114(b)(4)(B) of the Internal Revenue Code of 1939, as Amended, and That Appellee's "Gross Income From the Property" Is Not to Be Reduced on Account of Such Additives.

1. The Nature and Role of the Additives at Issue.

The calcium carbonate rock which appellee extracted from its Colton Quarry and Slover Mountain deposit was a high calcium limestone composed essentially of calcium carbonate and containing impurities in the form of magnesium carbonate, silica, iron oxide, and aluminum oxide. All of these impurities were useful in the production of cement except the magnesium carbonate.[26]

The processes applied by appellee to produce cement from its calcium carbonate rock may be summarized as follows:[27]

(1) Quarrying and crushing (both primary and secondary) of the calcium carbonate rock.

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[26]Pre-Trial Conference Order, Para. 3(b) and 3(e) [First Record 72-74]; Exhibit 19. Due to the finality of the earlier decision of the District Court to the effect that the shale impurities contained in appellee's calcium carbonate rock are not to be separately considered for percentage depletion purposes [F. of F. No. 18 and C. of L. No. 4; First Record 140, 146], the references in the Pre-Trial Conference Order to "shale" extracted from the Colton Quarry and the Slover Mountain deposit should be ignored for purposes of this appeal.

[27]Pre-Trial Conference Order, Para. 3(c) [First Record 72-73].

(2) Raw grinding and blending of the calcium carbonate rock together with varying amounts of iron ore and quartzite to obtain a properly proportioned raw mixture which is then ready for introduction into the kilns.

(3) Dead burning and sintering of the raw mixture (the "kiln-feed material") in rotary kilns to produce cement clinker.

(4) Finish grinding of the clinker together with a proper proportion of gypsum, and sometimes of other materials, to the desired fineness.

The dead burning and sintering process which occurs in the kilns (referred to as "calcination") causes complex chemical reactions between the chemical constituents of the calcium carbonate rock and of the iron ore and quartzite which result in the formation of new chemical compounds. The mixture of new compounds created as a result of such calcination issues from the kilns in the form of small pellets known as cement clinker. Cement meeting market specifications cannot be made unless these chemical reactions have occurred and unless such reactions create these new compounds in the clinker in certain specified acceptable proportions. Such proportions are determined in the instance of appellee by the chemical composition and proportions of the calcium carbonate rock, iron ore, and quartzite calcined in the rotary kiln. The four basic chemical constitutents which must be present in the kiln-feed material, if acceptable cement is to be made, are calcium carbonate, silica, iron oxide, and aluminum oxide.[28]

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[28]Pre-Trial Conference Order, Para. 3(e) [First Record 72-73]; First Record 305-306; 447-449, 482-483.

The processes so applied by appellee to produce its cement were essentially the same as those applied in the cement industry throughout the entire United States as well as in the Southern California area. The gypsum added to the clinker in the finish grinding process served to retard the setting time of the cement within certain prescribed limits. The other additives introduced in the finish grinding stage were intended to add special properties to the resultant finished cement.[29]

In various parts of the United States, cement producers mine or quarry as their basic raw material a form of calcium carbonate rock known as "cement rock." In addition to its calcium carbonate content, cement rock contains silica, iron oxide and aluminum oxide impurities in proportions corresponding to those desired in the kiln feed material. As a consequence, such producers are able to make specification cement directly from their cement rock without the need to introduce any other materials as additives prior to calcination in the rotary kilns.[30] Other members of the industry, such as appellee, do not possess enough of such silica, iron oxide, and aluminum oxide impurities in their calcium carbonates raw material. Such deficiencies are made up by adding desired quantities of such source materials as iron ore and quartzite in the course of the raw grinding process prior to calcination.[31]

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[29]First Record 364-369, 391-392, 444-449, 481-483; Exhibit U.

[30]First Record 447; Exhibit U. Descriptions of "cement rock" and its processing are to be found in *Dragon Cement Company, Inc. v. United States,* 244 F. 2d 513 (1st Cir. 1957); and *Portland Cement Company of Utah v. United States,* ..... Fed. Supp. ..... (1960-2 USTC, par. 9534) (DC Utah, 1960).

[31]First Record 391-392, 447-448, 481-483.

Accordingly, the "additives" involved for the taxable years concerned fall into two clearly defined categories as follows:[32]

(1) Quartzite and iron ore, which were added to appellee's calcium carbonate rock in the raw grinding process prior to the introduction of the raw mix into the rotary kilns.

(2) Gypsum and other materials, which were added to the clinker in the finish grinding process after calcination.

2. The Proportionate Costs and Profits Formula.

As stated earlier, the parties agreed at the second trial that appellee's depletion allowances for its calcium carbonate rock processed in its cement plant and lime plant are to be computed by reference to a kiln-feed cut-off point through application of the proportionate costs and profits or "rollback" method specified by Treasury Regulations 111, Section 29.23(m)-1(e)-(3), as follows:

> "If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes."

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[32]The respective tonnages and origin of each of these additives are set forth in Paragraph 3(y) of the Pre-Trial Conference Order [First Record 84-85].

This method is commonly expressed by the following arithmetical formula:

$$\frac{\text{Costs incurred prior to the cut-off point in obtaining the product sold}}{\text{Total costs incurred in obtaining the product sold}} \times \text{Net sales of the product sold} = \text{Gross income from the property}$$

Once the cut-off point has been ascertained, it is then assumed that any profit realized on the sale of the product actually sold is to be allocated proportionately to the respective costs involved in each processing step before and after the cut-off point. Thereby, a constructive "gross income from the property" and "gross income from mining" is determined: the sum of (i) the costs incurred prior to the cut-off point, and (ii) the proportionate share of the overall profit treated as allocable to those steps in the processing operation which occur prior to the cut-off point. The application of this "rollback" formula may be exemplified as follows:

Costs incurred before the cut-off point:	$2.00 per ton or 40%
Costs incurred after the cut-off point:	3.00 per ton or 60%
Total costs incurred:	$5.00 per ton or 100%
Selling price of the product sold:	$8.00 per ton
Less: Total costs incurred:	5.00 per ton
Profit realized on sale of the product sold:	$3.00 per ton

The constructive "gross income from the property" at the cut-off point would then be $3.20 per ton, which is the sum of (i) the costs incurred before the cut-off point ($2.00 per ton), plus (ii) the proportionate profit attributable to processing prior to the cut-off point (40% of total profit of $3.00 per ton=$1.20 per ton).

Inherent in use of the proportionate costs and profits formula are two basic assumptions: first, that no value or cost is to be assigned to the taxpayer's mineral in its raw state and, second, that each individual step or operation in the stream of treatment processes applied to obtain the product sold produces a fraction of the overall profit which is directly proportionate to the ratio between the costs incurred in that particular operation and the total costs incurred. The higher the percentage of the total costs which is incurred prior to the cut-off point, the greater the constructive "gross income from the property" forming the depletion base, and vice versa.[33]

Accordingly, the manner in which particular items of cost are handled under the formula (and the determination as to whether they are to be included in the computation at all) can have a major effect on the amount of the taxpayer's percentage depletion allowances. The applicable Treasury Regulations are silent on the point, so it becomes a matter of applying equity and logic in answering these questions. Such was the approach adopted by the Court below.

3. The Respective Positions of the Parties.

The method of computation sought by the appellee and adopted by the District Court in its decision is set forth in the schedules appearing at pages 23 to 36

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[33]If all the facts in the above example are the same except that the respective figures for costs before and after the cut-off point are reversed, then the result is changed drastically as follows:

$$\frac{\text{\$3.00 (costs incurred before the cut-off point)}}{\text{\$5.00 (total costs incurred)}} \times \text{\$8.00 (selling price of the product sold)} = \text{\$4.80 (gross income from the property)}$$

of the Second Record.[34] The method which the appellant asserted and which the District Court rejected as improper is set forth in Exhibits 29 and 33. As the appellant did not appeal from the portions of the decision below relating to the handling of discounts and the income and expenses of the sacking operation for proportionate costs and profits purposes, the difference between such methods relating to those items will be ignored in this brief.

The basic differences between appellee's method and that of the appellant with respect to the handling of "additives" are as follows:

Appellant's Method treats the costs of all additives used in the production of cement clinker and finished cement as having been incurred after the kiln-feed cut-off point regardless of whether they were actually introduced in the raw grinding process (before the cut-off point) or in the finish grinding process (after the cut-off point). As a concomitant of this position, appellant treats a portion of the raw grinding process expense as being allocable to additives and includes it in costs incurred after the cut-off point for this purpose even though such grinding expense was in fact incurred prior to the kiln-feed stage. Appellant's method does not reduce either the net sales figure (which forms the starting point for application of the proportionate costs and profits equation) or the total costs figure on account of additives. By so treating a substantial por-

[34]The slight variance between the figures set forth in such schedules and those contained in Exhibit 34 is due to the adjustments made following the trial to reflect bulk loading costs in light of the ruling of the trial court that appellee is to be treated as though it had sold all its products in bulk. F. of F. No. 28 [Second Record 17]; Second Record 74-75, 95-96, 159-160, 164-167.

tion of the expense which was actually incurred prior to the cut-off point as though it had been incurred after the kiln-feed stage, the appellant artificially decreases the cut-off point ratio which is then applied to the net sales figure to determine the "gross income from the property."[35]

Appellee's Method follows the actual flow of material in accounting for the cost of particular additives as having been incurred before or after the kiln-feed cut-off point according to the specific stage in the processing at which they were introduced. Consistent with this approach, all of the raw grinding process expense is treated as having been incurred prior to the cut-off point. Neither the net sales figure nor the total costs figure are reduced on account of additives. In other words, the only difference is that appellee's method follows its books of account and the actual processing steps in reflecting particular additive costs as having been incurred before or after the cut-off point in determining the all-important cost ratio.[36]

Reduced to a simple equation, the difference between the two methods may be exemplified as follows:

Assumptions:	
Selling price per barrel of cement in bulk:	$3.00
Costs incurred per barrel of cement in bulk:	
Additives introduced before the cut-off point (iron ore and quartzite):	$0.15
Other costs incurred before the cut-off point:	0.85
Total costs incurred before the cut-off point:	$1.00
Additives introduced after the cut-off point (gypsum, etc.):	$0.20
Other costs incurred after the cut-off point:	0.80

[35]Exhibits 29 and 33; Second Record 98-99, 105-107.

[36]Exhibit 34; Second Record 101-102, 105-109.

Total costs incurred after the cut-off point:	$1.00
Total costs incurred:	$2.00
Profit per barrel of cement in bulk:	$1.00

Appellant's Method:

Actual costs incurred before the cut-off point:	$1.00
Less: Additives introduced before the cut-off point:	0.15
Constructive costs incurred before the cut-off point:	$0.85
Actual costs incurred after the cut-off point:	$1.00
Add: Additives introduced before the cut-off point:	0.15
Constructive costs incurred after the cut-off point:	$1.15
Total costs incurred:	$2.00
Cut-off point ratio ($0.85/$2.00):	42 ½%

Selling price per barrel of cement in bulk ($3.00)	×	Cut-off point ratio (42½%)	=	Gross income from the property ($1.275)

Appellee's Method:

Actual costs incurred before the cut-off point:	$1.00
Actual costs incurred after the cut-off point:	$1.00
Total costs incurred:	$2.00
Cut-off point ratio (1.00/$2.00):	50%

Selling price per barrel of cement in bulk ($3.00)	×	Cut-off point ratio (50%)	=	Gross income from the property ($1.50)

As will be shown below, the method of computation sought by the appellee and adopted by the District Court in its decision is the correct one and is in full accord with the provisions of the depletion statute. Moreover, this method has the great advantages of simplicity and logic and it thus avoids the complexities

of computation to which this Court alluded in the first *Monolith* decision.[37]

4. Appellee's Method of Computation Follows the Provisions of the Depletion Statute.

As pointed out earlier, the parties are in agreement that the computation of appellee's depletion allowances with respect to its calcium carbonate rock used in the production of cement clinker and finished cement for the taxable years at issue is to be made in accordance with the provisions of Section 302(b) of the Public Debt and Tax Rate Extension Act of 1960 (commonly referred to as the "Gore Amendment"). The pertinent language of this statute is as follows (emphasis supplied):

> "(4) *Treatment processes considered as mining.*— The following treatment processes where applied by the mine owner or operator shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under Section 611:
>
> * * * * *
>
> "(f) in the case of calcium carbonates and other minerals when used in making cement—*all processes (other than preheating the kiln feed) applied prior to the introduction of the kiln feed into the kiln,* but not including any subsequent process;"

By so amending the Internal Revenue Code of 1954 and making the amendment applicable to taxable years governed by the Internal Revenue Code of 1939 on an elective basis, Congress adopted the basic kiln-feed cut-

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[37] *Monolith Portland Cement Company v. United States,* 269 F. 2d 629 (9th Cir., 1959), at 633.

off point long asserted by the Internal Revenue Service[38] and made clear its intention that *all processes* applied by cement producers up to that point are to be treated as "mining" regardless of how they might be characterized by a layman. This amendment was intended to put an end to the protracted litigation involving depletion allowances for the cement industry which had plagued the Courts for so many years and to provide a simple, easily-applied method of computation.[39] Expressed another way, the Gore Amendment and Public Law 86-781 were specifically designed to resolve the controversy as to where "mining" ended and "manufacturing" begins in the case of cement production and to obviate the need for further recourse to the Courts to resolve this question in light of the *Cannelton* decision.[40] The position taken by the appellant here on the "additives" question is in effect an attempt to thwart the purpose behind this legislation and to raise anew the "mining vs. manufacturing" issue by a backdoor route.

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[38]Revenue Ruling 290, 1953-2 C.B. 41.

[39]As was stated in explanation by Mr. Wilbur Mills, Chairman of the Ways and Means Committee, on June 27, 1960 (Congressional Record, p. 13498):

> "There is no change in the processes allowed under present law with respect to that operation. What we are talking about in this is the cutoff point for limestone that is used, say, in the cement business. We have a particular section here on that. We say that we will not permit that cut-off point to go beyond the kiln feed, where it is fed into the kiln for purposes of processing. Up to that point, yes, we allow percentage depletion, but not in the manufacturing process."

[40]Senate Finance Committee Report No. 1910 to accompany H.R. 7885 (86th Congress, 2nd Session; August 24, 1960), Pp. 7-9. The full text of this report is printed as Appendix C in the Supplemental Brief of Appellee, California Portland Cement Company, filed with this Court in Case No. 16438.

The parties have stipulated that the addition of the pre-kiln additives (iron ore and quartzite) in the raw grinding stage was a "process" applied by appellee to its calcium carbonate rock in producing cement clinker and finished cement and that such products could not have been made were it not for this step in the processing.[41] In view of this stipulation on the part of appellant and the fact that this process was applied well prior to the statutory cut-off point, it must perforce be treated as "mining" under the express language of Section 302(b) that the term encompasses "all processes * * * applied prior to the introduction of the kiln feed into the kiln." Once it is so established that a particular process constitutes "mining", then the provisions of Treasury Regulations 111, Section 29.23 (m)-1(e)(3), quoted above require that the costs of such process are to be treated as having been incurred prior to the cut-off point in applying the proportionate costs and profits formula. Such was the ruling of the District Court in determining the amount of appellee's depletion allowances and the resultant refunds: as the iron ore and quartzite were added in the raw grinding stage as a process applied prior to the cut-off point, the related costs must be taken into account in the manner asserted by appellee.

Appellant attempts to circumvent the effect of this stipulation by a chain of syllogistic reasoning which ignores the clear intendment of Section 302(b) and finds solace in the statutory phrase "to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under

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[41]Pre-Trial Conference Order, Para. 3(c), 3(d), and 3(e) [First Record 72-74].

Section 611." In so doing, appellant seeks to confuse the issue by quoting from the pertinent Conference Committee Report out of context.[42]

Reduced to its essentials, appellant's theory is that the addition of the iron ore and quartzite in the course of the raw grinding is not a process "applied to" appellee's calcium carbonate rock and that the inclusion of the cost of such additives in the costs incurred before the cut-off point in the rollback equation allows depletion on the additives in the guise of a depletion allowance on the calcium carbonate rock.[43] As the keystone of its reasoning, appellant refers to the following language in the pertinent Conference Committee Report: "Under the language of this provision, a described process is not treated as mining where applied to a purchased ore or mineral."[44]

A careful reading of the Conference Committee Report (reproduced as Appendix C to this brief) as well as the other legislative history materials cited by

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[42]For the convenience of the Court, the full text of the pertinent provisions of the Conference Committee Report (1960-2 C.B. 746-747) is set forth in Appendix C hereto. The portions selected by the appellant are contained in Appendix C to its brief.

[43]Appellant's Brief, Pp. 10-11, 15-17. The statement appearing on page 15 of the appellant's opening brief with regard to the distinction between the costs incurred in blending the pre-kiln additives with the limestone and the costs of such additives themselves indicates that appellant now concedes that the former category of expense was properly treated by the District Court as a "mining" cost under the proportionate costs and profits formula. As noted earlier, at the trial appellant unsuccessfully sought to have a portion of the costs of the raw grinding process treated as "non-mining" expense incurred after the cut-off point. This concession significantly narrows the scope of the "additives" issue as now presented to this Court.

[44]Appellant's Brief, P. 17.

the appellant establishes that the quoted language has no bearing on this proceeding.

Depletion allowances are, of course, granted to compensate for the exhaustion of mineral deposits as a consequence of extraction and sale and as such are limited in their application to the owner of an "economic interest" in the deposit concerned who must look to the proceeds from the sale of the mineral for return of his capital investment.[45] For this reason, no depletion allowances are granted to one who has a mere "economic advantage" related to the mineral deposit or material extracted therefrom.[46] Thus, by reason of the fact that he is not a "mine owner or operator", one who purchases all of his mineral raw material at the mouth of another's mine or quarry and thereafter processes it receives no depletion allowances even though the processes applied after purchase fall within the statutory concept of "mining". The testimony adduced at the first trial of this action, as well as that presented to Congress in connection with the provisions of the depletion statute relating to calcium carbonates, brought out the fact that there are a number of cement plants in the United States that purchase all or virtually all of their calcium carbonates raw material. The quoted language from the Conference Committee Report and the corresponding language in Section 302(b) itself were intended solely to prevent any inadvertent entitlement to depletion allowances on the part of one who so purchased the calcium carbonates requirements of his cement plant. In short, the Gore Amendment was limited

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[45]*Commissioner v. Southwest Exploration Company,* 350 U.S. 308 (1956).

[46]*Parsons v. Smith,* 359 U.S. 215 (1959); *Helvering v. Bankline Oil Company,* 303 U.S. 362 (1938).

in its scope to an integrated miner-manufacturer member of the cement industry such as the appellee which extracted its own calcium carbonates and would otherwise have been involved in extensive post-*Cannelton* litigation regarding the cut-off point to be applied.

These legislative history materials establish that the members of the congressional committees concerned had considerable knowledge of the logistics of the cement industry and the nature of the processes applied both before and after the cut-off point in the production of cement, including the special situation of "cement rock" with its desirable impurities and the fact that other calcium carbonates sources required the addition of silica, iron oxide, and/or aluminum oxide in the pre-kiln stage to make up any deficiencies in such impurities. Had it wished to exclude either the addition of such additives or the portion of the raw grinding operation allocable to them, Congress could readily have done so. Instead, it chose to adopt the position that "all processes" applied prior to the cut-off point are to be treated as "mining", without exception.

Long-established is the principle of statutory construction that the specific is to govern over the general in event of conflict. In this regard, one portion of Section 302(b) states that certain processes are not to be included as "mining" unless otherwise provided for in the specific enumerations of allowable processes, and two of the processes so excluded under the general rule are "fine pulverization" and "blending with other materials."[47] Both of the latter two processes occur

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[47]Section 613 (c)(5) of the Internal Revenue Code of 1954 as added by Section 302(b) of the Public Debt and Tax Rate Extension Act of 1960.

prior to the kiln-feed cut-off point in the production of cement and thus would not be treated as "mining" were it not for the fact that they are covered by the specific category of "all processes (other than preheating of the kiln feed) applied prior to the introduction of the kiln feed into the kiln" applicable here. By its use of the specific phrase "all processes" and its failure to have the exclusion of "blending with other materials" apply to cement production, Congress has entered a clear mandate that the addition of pre-kiln additives to the calcium carbonates in the course of raw grinding is to be considered as part of the "mining" operation for percentage depletion purposes. By so doing, it has merely recognized the situation of cement producers such as appellee who must look elsewhere for the desirable impurities and has placed them on a par with those using "cement rock".

Completely without foundation is appellant's argument that the addition of the iron ore and quartzite is not a process "applied to" appellee's calcium carbonate rock. As noted above, the structure and language of Section 302(b) establish that Congress viewed "blending with other materials" such as that now at issue as being a process which in fact is "applied to" the mineral being depleted. When, as here, such blending falls within one of the enumerated categories of allowable treatment processes, it is to be treated as part of the "mining" operation. In other words, Congress intended that the addition of additives would, in particular cases, be just as much an allowable "process" as are crushing or grinding concerning which there is no dispute in this proceeding.

Equally inaccurate is appellant's citation of dicta from *United States v. Utco Products,* 257 F. 2d 65 (10th Cir., 1958), as establishing that the addition of the pre-kiln additives is not a process involving "treatment" of the mineral being depleted. This case was decided under the law as it existed prior to the Gore Amendment, which now specifically provides that such addition or blending is a "treatment process". Accordingly, it is immaterial whether this step is one which would be viewed as "treatment" by the *Utco* Court. In passing, however, it should be noted that as the removal of undesirable impurities constitutes "treatment" under the dicta of the *Utco* case, it is just as logical so to characterize the addition of desirable impurities such as that involved here.

As respects appellant's final premise that the District Court's decision permits depletion on the pre-kiln additives in the guise of granting depletion on the calcium carbonate rock mined by appellee, it suffices to say that a similar contention was unequivocally rejected by this Court in the first *Monolith* case. As will be shown below, such decision on this point has not been affected by the subsequent ruling of the Supreme Court in the *Cannelton* case and is completely consistent with the intendment of the statute and the pertinent Treasury Regulations.

For the reasons stated, appellee submits that the District Court correctly applied the language of Section 302(b) in holding that the addition of the pre-kiln additives was a "process" in the "mining" of appellee's calcium carbonate rock and is to be treated as such under the proportionate costs and profits formula in determining the amount of appellee's "gross income from the property" and "gross income from mining".

5. Appellee's Method Is in Accord With the Decision of This Court in the First Monolith Case.

Prior to the entry of the Supreme Court's decision in *United States v. Cannelton Sewer Pipe Company,* 364 U. S. 76, on June 27, 1960, the lower courts had decided more than 50 cases in favor of the end-product approach to computing percentage depletion allowances. One of the landmark decisions during this period was that entered by this Court on July 2, 1959 in the first *Monolith* case.[48]

In the latter proceeding the District Court had held that the taxpayer's percentage depletion allowances with respect to calcium carbonates used in the production of cement were to be computed by reference to the proceeds realized from the sale of finished cement in bulk, without any deduction on account of the additives utilized, as its "gross income from the property". When an appeal was taken to this Court, the Government did not question application of the finished cement end-product depletion base as such but, instead, limited the issue presented on appeal to the handling of the additives. In so doing, the Government conceded that the physical act of blending the additives with the taxpayer's calcium carbonates source mineral was one of the "ordinary treatment processes" allowable under the statute but argued that the income attributable to the additives themselves should not be included in the depletion base. In holding for the taxpayer, this Court stated (269 F. 2d 629, 633):

> "In our view the addition of the relatively small amounts of other materials was part of the 'ordi-

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[48] *Monolith Portland Cement Company v. United States,* 269 F. 2d 629, *aff'g.* 168 Fed. Supp. 692 (S.D. Calif., 1958).

nary treatment' process in converting limestone into Portland cement. We perceive no reason for distinguishing between the cost of the additives and the cost of blending them with limestone in computing the depletion base * * *

"We find no warrant in the statute for excluding from this gross income that part representing the value of the additives. To say that the addition of other materials was not a part of the ordinary treatment process is to undercut the accepted finding that Portland cement, which requires the addition of such materials, is the first marketable product resulting from the use of ordinary treatment processes.

"The method of computation employed by the trial court does not allow depletion on the additives. Depletion is allowed a mine owner for exhaustion of his natural deposit. As a practicable way of computing that depletion, the gross income from the sales of the marketable product of the mine is taken as a base. This is only a method of computation. It does not represent the allowance of depletion on any process or product. *Dragon Cement Company v. United States,* 1 Cir., 244 Fed. (2d) 513, 516.

"The Government's proposal would introduce complexities which would make it difficult to compute a depletion allowance with any assurance. As Monolith points out in its reply brief, at least five different methods of computation involving nine possible variants would have to be taken into consideration. In our view Congress intended to provide a simple, practical rule which could be applied

with some measure of confidence in computing the depletion deduction. See *Dragon Cement Company v. United States, supra,* pages 514, 516. The method utilized by the District Court accords with that intention. The method proposed by the Government does not."

Although its opening brief is silent on the subject, appellant may be expected to argue that the vigor of this Court's ruling on the additives question has been weakened by the subsequent *Cannelton* decision or the enactment of the Gore Amendment and Public Law 86-781. Such is not the case, and in fact this Court's prior holding continues to be determinative of the issue here.

In the *Cannelton* case the Supreme Court was concerned solely with establishing where the cut-off point should be set in the case of an integrated miner-manufacturer under the prior law. Rejecting the profitability test adopted by the lower courts as part of the end-product approach, the Supreme Court took a narrow view of the statute and ruled that "mining" ceases when the taxpayer's mineral has first reached a point where it is marketable as such even if the taxpayer does not actually sell at that point or could not do so except at a loss. As a concomitant, the *Cannelton* decision has been read by some as holding that only those treatment processes specifically enumerated in the statute as allowable may be considered part of the "mining" operation. In other words, the Supreme Court merely established broad, general principles to be applied in determining where "mining" ceases and "manufacturing" begins for percentage depletion purposes and did not concern itself with how the "gross income from the property" is then to be computed by reference to this cut-off point.

Subsequently, in the second *Monolith* case,[49] this Court was called upon to determine the appropriate depletion allowances for later taxable years of the Monolith organization, which had not elected under Public Law 86-781 to have the kiln-feed cut-off point provisions of Section 302(b) apply on a retroactive basis. After considering the Government's arguments as to the weight to be given the *Cannelton* decision and the taxpayer's arguments as to *res judicata,* this Court again ruled that Monolith's depletion base is its income from sales of finished cement in bulk without any deduction on account of the additives utilized. Thereafter, in a *per curiam* action taken upon consideration of the Government's application for the issuance of a writ of *certiorari* without the benefit of briefing and argument, the Supreme Court reversed this Court's decision in the second *Monolith* case and remanded it for further proceedings on the basis of computing depletion allowances by reference to crushed rock as the cut-off point.[50] Here again the Supreme Court did not address itself to the manner in which such computation is then to be made on remand.

As noted earlier, appellee California Portland Cement Company is not concerned with the effect of the decisions by the Supreme Court in the *Cannelton* case and the second *Monolith* case, which dealt only with the determination of the proper cut-off point and did not reach the question of how the "gross income from the property" at that point should be computed. Here the cut-off point is established at the kiln-feed stage by ex-

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[49]*Monolith Portland Cement Company v. Riddell,* 301 F. 2d 488 (1962), *aff'g.* .... Fed. Supp. ..... (60-1 U.S.T.C., Para. 9187) (SD Calif., 1960).

[50]371 U.S. 537 (1963).

press statutory language not at issue in those cases, and this same statute enumerates the processes which are to be treated as "mining" for purposes of the computation. As the parties are in agreement that the constructive "gross income from the property" at the kiln-feed stage is now to be computed by the proportionate costs and profits method, the only step remaining is the determination of the costs to be considered and whether they are to be treated as having been incurred before or after the cut-off point. It is on this latter issue that the decision of this Court in the first *Monolith* case is controlling and fully supports appellee's position.[51]

Although there is some difference in the descriptive nomenclature, the additives involved in the Monolith operation prior to the kiln-feed stage are essentially the same as those utilized by the appellee and served the same purpose in the production of cement clinker and finished cement by the same processes. In each instance the pre-kiln additives served merely to supplement the silica, iron oxide, and aluminum oxide content of the calcium carbonates source mineral used and were added

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[51]In reviewing the "ordinary treatment processes" specifically enumerated in the statute prior to the Gore Amendment, the Supreme Court commented in the *Cannelton* case (364 U.S. 76, 85-86): "Furthermore, none of the permissible processes destroy the physical or chemical identity of the minerals or permit them to be transformed into new products." Here the pre-kiln additives utilized by appellee did not react chemically with the chemical constituents of its calcium carbonate rock until the calcination stage, subsequent to the kiln-feed cut-off point, and thus their addition in the raw grinding stage was not a process which so changed the physical or chemical identity of appellee's calcium carbonate rock. Accordingly, quite apart from the Gore Amendment, there is nothing in the *Cannelton* decision which bears on the status of such additives introduced before the cut-off point.

in the raw grinding process. Accordingly, there are no grounds for any factual distinctions between the first *Monolith* case and this proceeding.

As was brought out so graphically by this Court in its opinion in the first *Monolith* case, the computation of the dollar base to which the applicable percentage rate is then applied to provide the amount of the depletion allowance requires two separate steps. The first involves establishing the amount of the sales income from the product actually sold which forms the starting point in the equation. The second is the determination whether all of such sales income or only a portion thereof is to be taken into account as the "gross income from the property". It is the second step which requires establishment of the proper cut-off point—at the end-product, at the mouth of the mine or quarry, or at some intermediate point such as the kiln-feed stage. The amount determined by the first step remains constant regardless of the cut-off point so established.

In *Monolith,* this Court held that as the starting point determined in the first step there should be used the gross income derived from the sale of cement in bulk without any deduction on account of the additives utilized. The reason was that the addition of these other materials was an essential step in the processing applied to obtain the product of bulk cement actually sold. As the second step, this Court then held that there was no cut-off point short of the end-product and thus 100% of the amount determined in the first step is to be taken as the "gross income from the property". In the proceeding at bar, the parties are now in agreement that the amount of appellee's sales of finished cement in bulk (together with by-product clinker

sold as such) is similarly to be used as this starting point figure without any reduction in such sales income on account of the additives involved.[52] It is only when the second step is reached that there is a difference of opinion. Although the parties are agreed on the cut-off point, they differ as to the applicable percentage to be applied to the figure obtained in the first step. As explained previously, the variance as to this percentage is due solely to the question whether the cost of the pre-kiln additives is to be treated as having been incurred in the flow of processes prior to the cut-off point (which was the fact!) or as having been incurred at a later stage (contrary to the actual fact).

Appellee submits that the teachings of this Court in the first *Monolith* case establish decisively that appellee's method of computing this percentage is the correct one. Rephrasing the language of this Court quoted earlier in light of the kiln-feed cut-off point here involved, the prinicple can be stated as follows:

> "* * * To say that the addition of [the iron ore and quartzite] was not a part of the ordinary treatment process is to undercut the accepted finding that [the kiln-feed raw mix], which requires the addition of these materials, is the first marketable product resulting from the use of ordinary treatment processes.
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> "The method of computation employed by the trial court does not allow depletion on the additives.

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[52]Exhibits 29, 33, and 34; Appellant's Brief, Pp. 9, 13. Appellant's failure to seek a deduction from the gross sales figure on account of additives is, of course, inconsistent with appellant's method of handling their costs in the rollback equation and the position urged by the Government in the first *Monolith* case.

> Depletion is allowed a mine owner for exhaustion of his natural deposit. As a practical way of computing that depletion, the gross income from the [constructive value] of the marketable product of the mine [i.e., such kiln-feed raw mix] is taken as a base. This is only a method of computation. It does not represent the allowance of depletion on any process or product. * * *"

Expressed another way, this Court has ruled that where the addition of additives is an essential process applied in obtaining the marketable product in question, the income from sales of that product used in the "gross income from the property" computation is not to be reduced in any manner on account of such additives. This is true whether the reduction is asserted at the first step, as in the first *Monolith* case, or at the second step, as is the position of appellant here.[53] Similarly, it makes no difference for this purpose whether the cut-off point between "mining" and "manufacturing" is placed at the end-product stage or at an intermediate stage such as the kiln-feed point.

Accordingly, it is clear that this Court already has carefully considered and completely rejected appellant's last ditch argument that the District Court's decision has the effect of giving appellee a depletion allowance with respect to the iron ore and quartzite in the guise

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[53]Appellant's reduction of the "gross income from the property" by re-classifying pre-kiln additives costs as having been incurred after the cut-off point in determining the percentage ratio in the second step has the same practical effect as the reduction of gross sales income on account of additives in the first step unsuccessfully sought in the first *Monolith* case. In either event, appellant removes the portion of the depletion base which is attributable to an essential step in the "mining" operation.

of depletion for its calcium carbonate rock.[54] One might just as illogically argue that depletion is being granted with respect to the fuel and water consumed by appellee prior to the kiln-feed stage in its cement plant, the expense of which has at all times been conceded by appellant to be a "mining" cost. By the same token it is immaterial whether these additives or such fuel or water were purchased by the appellee or extracted from its own mineral deposits.[55] As the method of computation here at issue does not grant any depletion allowance with respect to the additives, the spectre of double depletion raised by appellant is purely imaginary.

6. Appellee's Method Is Simple, Logical and in Accord With Sound Accounting Practice.

In its opinion in the first *Monolith* case, this Court indicated grave concern with the great complexities of computation introduced by appellant's position regarding additives and instead adopted what it considered "a simple, practical rule which could be applied with some measure of confidence in computing the depletion deduction."[56] This is the method here asserted by appellee and reflected in the decision of the court below.

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[54]In accord with this Court's decision regarding the treatment of additives are *Northwest Magnesite Co. v. United States,* ..... Fed. Supp. ..... (58-1 USTC, Par. 9394) (E.D., Wash., 1958); and *Sparta Ceramic Co. v. United States,* 168 Fed. Supp. 401 (N.D. Ohio, 1958), *rev'd.* on other grounds 286 F. 2d 429 (6th Cir., 1961).

[55]Coal, oil, and natural gas used as fuel are, of course, subject to depletion allowances in the hands of their producers. At least one Court has made a similar ruling in the case of ground water. *Shurbet v. United States,* ..... Fed. Supp ..... (63-2 USTC, Par. 9528) (N.D. Tex., 1963).

[56]269 F. 2d 629, 633.

As pointed out earlier, the pertinent Treasury Regulations go no further than to prescribe in the most general of terms that the basic proportionate costs and profits method shall be utilized to determine the constructive "gross income from the property" at the cut-off point in a case like that of the appellee and leave the actual details of what costs are to be taken into account and how they are to be handled open for *ad hoc* decision in each individual situation. The appellant's own witness, Revenue Agent Sumida, established that no set or uniform rules had been adopted by the Internal Revenue Service for this purpose and that he had just applied his own individual judgment on audit of appellee's returns for the taxable years in controversy.[57]

Mr. Charles F. Reinhardt, a certified public accountant with broad experience in all phases of tax and book accounting for integrated miner-manufacturer concerns such as appellee,[58] was called upon to contrast appellant's method with that which was subsequently adopted by the District Court. His testimony established to the satisfaction of the trier of fact that appellant's method created a distorted result whereas appellee's method was simple, logical, and in accordance with sound principles of accounting.[59]

Stated another way, appellee's method accounts for all costs at the point where they actually were incurred in the flow of processes and follows its books of account in treating particular items of expense as having been incurred before or after the cut-off point. If

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[57]Second Record 130-131.

[58]Second Record 81-88, 91.

[59]Second Record 96-105.

a particular process such as the addition of iron ore and quartzite occurred prior to the kiln-feed stage, then all of the related costs are accounted for in the numerator of the equation accordingly. It is difficult to imagine any simpler or more logical approach. Appellant's method, on the other hand, departs from all concepts of sound cost accounting by arbitrarily reclassifying costs which should properly go in the numerator. In so doing, appellant deserts the realities of the situation and opens a Pandora's box of complex accounting problems. This is just the sort of situation, in which every Revenue Agent would have a different theory and in which no taxpayer could file its returns with any prospect of certainty or uniformity of treatment, that this Court sought to avoid in the first *Monolith* case.[60]

When, as in the case at bar, it has been established that a particular process is an integral part of the operations treated as "mining" under the statute, then all of the costs relating to that process must be included in the numerator of costs incurred prior to the cut-off point in the rollback equation. Any other result would do violence to the statute.

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[60]The fact that Mr. Sumida's treatment on audit followed in part the computations applied by the appellee on its return for the taxable year ended April 30, 1952 is symptomatic of this potential problem. At the time this return was filed neither the Courts nor the Internal Revenue Service had given the appellee any guidance as to how the computations should be made. Today, some 11 years later and after more than 5 years of active litigation, the appellee is still seeking a final decision on the question.

B. If for Any Reason This Court Is Unable to Adopt the Method of Computation Reflected in the Decision Below, Then in the Alternative It Should Adopt the Proportionate Tonnage Method of Accounting for Additives.

At the second trial of this action the appellee pointed out that, as this Court observed in the first *Monolith* case, there are a great number of different possible methods of handling additives under the proportionate costs and profits formula. Although appellee was firmly of the opinion that the method it asserted (and which the District Court subsequently adopted in its decision) was the correct one and accorded fully with the express provisions of the Gore Amendment and the prior teachings of this Court, appellee recognized the possibility that some other result might be preferred. Accordingly, appellee also presented for the trial court's consideration an alternative method whereby the additives are accounted for on a proportionate tonnage basis.[61]

In actuality, the method asserted by appellant at the trial is wholly inconsistent with its basic premise that the rollback equation must be made in such a manner as to eliminate any depletion with respect to the iron ore and quartzite in the guise of depletion on appellee's calcium carbonate rock. This is true because appellant's method merely adjusts the costs element of the equation on account of the pre-kiln additives but makes no adjustment to the starting point gross sales figure with respect to any of the additives. Appellant's method thus is also inconsistent with the position the Gov-

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[61]Second Record 136-141.

ernment urged before this Court in the first *Monolith* case.

The alternative method which appellee presented to the court below would resolve this inconsistency by appropriately removing the additives from all elements of the equation. As such, should appellant's basic premise as to the status of additives for depletion purposes be upheld, this alternative method is far more realistic and thus vastly preferable to appellant's method in terms of both theoretical logic and accounting simplicity.

The operation of this alternative method, as presented at the trial and using the figures on pages 24, and 25, above where applicable, can be exemplified as follows:

Assumptions:	
Selling price per barrel of cement in bulk:	$3.00
Costs incurred per barrel of cement in bulk:	
Additives introduced before the cut-off point (iron ore and quartzite):	$0.15
Other costs incurred before the cut-off point:	0.85
Total costs incurred before the cut-off point:	$1.00
Additives introduced after the cut-off point (gypsum, etc.):	$0.20
Other costs incurred after the cut-off point:	0.80
Total costs incurred after the cut-off point:	$1.00
Total costs incurred:	$2.00
Profit per barrel of cement in bulk:	$1.00
Origin of materials used in producing cement in terms of proportionate tonnage:	
Appellee's calcium carbonate rock:	95%
Additives:	5%

Appellee's Alternative Method:

Actual selling price per barrel of cement in bulk:	$3.00
Portion attributable to appellee's calcium carbonate rock:	x .95%
Adjusted selling price per barrel of cement in bulk:	$2.85
Actual costs incurred before the cut-off point:	$1.00
Less: Additives introduced before the cut-off point:	0.15
Constructive costs incurred before the cut-off point:	$0.85
Actual costs incurred after the cut-off point:	$1.00
Less: Additives introduced after the cut-off point:	0.20
Constructive costs incurred after the cut-off point:	$0.80
Constructive total costs incurred:	$1.65
Cut-off point ratio ($0.85/$1.65):	51.5+%

Adjusted selling price per barrel of cement in bulk ($2.85)	×	Cut-off point ratio (51.5+%)	Gross income from the property ($1.468+)

This alternative method is quite patently one which avoids the allowance of any depletion on account of the additives by any stretch of the imagination. First, as it is assumed that 5% of the total raw materials used in the cement plant operations are "additives", the starting point sales income figure is reduced by 5% to get that portion which is attributable solely to appellee's calcium carbonate rock. This means that none of the depletion base "gross income from the property" as finally determined under the proportionate costs and profits formula is attributable to the additives in any way. Second, in the interests of consistency, all costs

attributable to the additives are removed from both the numerator and the denominator used to determine the cut-off ratio. This latter step serves to reduce the equation to consideration of only those processing costs which relate to appellee's calcium carbonate rock as such. Thus, any profits which are due to use of the additives as well as their cost are entirely removed from the depletion base. In short, what remains as the "gross income from the property" is the constructive value of appellee's calcium carbonate rock in process at the kiln-feed cut-off point without any enhancement or diminution on account of the utilization of additives, real or imagined. This figure corresponds to that which would have been obtained had appellee mined a perfect "cement rock" and been able to make acceptable cement without using any other raw materials before or after the cut-off point.

Accordingly, if for any reason appellee's method as adopted by the District Court is not acceptable to this Court, then it is submitted that this alternative method which eliminates the additives from the equation altogether on a proportionate tonnage basis should be applied in preference to that asserted by the appellant and as being more in keeping with the principles previously enunciated by this Court in the first *Monolith* case.

V.
CONCLUSION.

Based on the record, and for the reasons developed in this brief, the District Court's Findings of Fact and Conclusions of Law should not be set aside. These findings and conclusions completely support the judgment, which should be affirmed.

In the alternative, and for the reasons developed in this brief, if for any reason appellee's method of accounting for additives is not acceptable to this Court, then this action should be remanded to the District Court with instructions to recompute appellee's depletion allowances and the resultant refunds by application of the alternative proportionate tonnage method described above.

Respectfully submitted,

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Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

STUART T. PEELER

APPENDIX A.

Statutes Involved.

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) Basis for Depletion.—

* * * * *

(4) [as amended by Sec. 319(a) of the Revenue Act of 1961, c. 621, 65 Stat. 452] *Percentage depletion for coal and metal mines and for certain other mines and natural mineral deposits.*—

(A) *In General.*—The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be—

* * * * *

(ii) in the case of * * * calcium carbonates * * *, 10 per centum.

* * * * *

(B) [as added by Sec. 124(c) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Definition of Gross Income From Property.*—* * *
(26 U.S.C. 1952 ed., Sec. 114)

Public Debt and Tax Rate Extension Act of 1960, P.L. 86-564, 74 Stat. 290:

SEC. 302. DEPLETION RATE FOR CERTAIN CLAYS; TREATMENT PROCESSES CONSIDERED AS MINING FOR COMPUTING PERCENTAGE DEPLETION IN THE CASE OF MINERALS AND ORES.

* * * * *

(b) *Treatment Processes Considered as Mining.* —Subsection (c) of Section 613 of the Internal Revenue Code of 1954 (relating to the definition of gross income from property) is amended as follows:

(1) By amending paragraph (2) to read as follows:

"(2) *Mining.* The term 'mining' includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto), and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that

the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills."

(2) By striking out paragraph (4) and inserting in lieu thereof the following new paragraphs:

"(4) *Treatment processes considered as mining.*—The following treatment processes where applied by the mine owner or operator shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under section 611:

* * * * *

"(F) in the case of calcium carbonates and other minerals when used in making cement—all processes (other than preheating of the kiln feed) applied prior to the introduction of the kiln feed into the kiln, but not including any subsequent process;

* * * * *

"(5) *Treatment processes not considered as mining.* Unless such processes are otherwise provided for in paragraph (4) (or are necessary or incidental to processes so provided for), the following treatment processes shall not be considered as 'mining': electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping."

(c) *Effective Date.*—The amendments made by subsections (a) and (b) shall be applicable only with respect to taxable years beginning after December 31, 1960.

Act of September 14, 1960, P.L. 86-781, 74 Stat. 1017:

SEC. 4. Subsection (c) of section 302 of the Public Debt and Tax Rate Extension Act of 1960 (Public Law 86-564; 74 Stat. 293) is amended to read as follows:

"(c) *Effective Date.*—

"(1) *In General.*—Except as provided in paragraph (2), the amendments made by subsections (a) and (b) shall be applicable only with respect to taxable years beginning after December 31, 1960.

"(2) *Calcium Carbonates, Etc.*—

"(A) *Election for past years.*—In the case of calcium carbonates or other minerals when used in making cement, if an election is made by the taxpayer under subparagraph (C)—

"(i) the amendments made by subsection (b) shall apply to taxable years with respect to which such election is effective, and

"(ii) provisions having the same effect as the amendments made by subsection (b) shall be deemed to be included in the Internal Revenue Code of 1939 and shall apply to taxable years with respect to which such election is effective in lieu of the corresponding provisions of such Code.

"(B) *Years to which applicable.*—An election made under subparagraph (C) to have the pro-

visions of this paragraph apply shall be effective for all taxable years beginning before January 1, 1961, in respect of which—

"(i) the assessment of a deficiency,

"(ii) the refund or credit of an overpayment, or

"(iii) the commencement of a suit for recovery of a refund under section 7405 of the Internal Revenue Code of 1954,

is not prevented on the date of the enactment of this paragraph by the operation of any law or rule of law. Such election shall also be effective for any taxable year beginning before January 1, 1961, in respect of which an assessment of a deficiency has been made but not collected on or before the date of the enactment of this paragraph.

"(C) *Time and manner of election.*—An election to have the provisions of this paragraph apply shall be made by the taxpayer on or before the 60th day after the date of publication in the Federal Register of final regulations issued under authority of subparagraph (F), and shall be made in such form and manner as the Secretary of the Treasury or his delegate shall prescribe by regulations. Such election, if made, may not be revoked.

"(D) *Statutes of limitation.*—Notwithstanding any other law, the period within which an assessment of a deficiency attributable to the application of the amendments made by subsection (b) may be made with respect to any tax-

able year to which such amendments apply under an election made under subparagraph (C), and the period within which a claim for refund or credit of an overpayment attributable to the application of such amendments may be made with respect to any such taxable year, shall not expire prior to one year after the last day for making an election under subparagraph (C). An election by a taxpayer under subparagraph (C) shall be considered as a consent to the application of the provisions of this subparagraph.

"(E) *Terms; applicability of other laws.*—Except where otherwise distinctly expressed or manifestly intended, terms used in this paragraph shall have the same meaning as when used in the Internal Revenue Code of 1954 (or corresponding provisions of the Internal Revenue Code of 1939) and all provisions of law shall apply with respect to this paragraph as if this paragraph were a part of such Code (or corresponding provisions of the Internal Revenue Code of 1939).

"(F) *Regulations.*—The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this paragraph."

* * * * *

APPENDIX B.

Treasury Regulations 111 (1939 Code):

Sec. 29.23(m)-1 [as amended by T.D. 5413, 1944 Cum. Bull. 124; T.D. 5458, 1945 Cum. Bull. 45; T.D. 5461, 1945 Cum. Bull. 284, and T.D. 6004, 1953-1 Cum. Bull. 45]. *Depletion of Mines, Oil and Gas Wells, Other Natural Deposits, and Timber: Depreciation of Improvements.*—

* * * * *

(f) The term "gross income from the property", as used in sections 114(b)(3) and 114(b)(4)(A) and sections 29.23(m)-1 to 29.33(m)-19, inclusive, means the following:

* * * * *

If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field

price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transporation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. * * *

Section 39.23(m)-1(e)(3) of Treasury Regulations 118 (1939 Code), effective January 1, 1952, is the same as the section set out above.

APPENDIX C.

House Conference Report No. 2005, 86th Cong., 2d Sess., Pp. 8-10 (1960-2 C.B. 741, 746-747) (relating to what became Section 302(b) of the Public Debt and Tax Rate Extension Act of 1960):

Effective date

Under the Senate amendment, the changes made by the amendment apply only with respect to taxable years beginning after December 31, 1960.

CONFERENCE SUBSTITUTE

Under the conference agreement the House recedes on Senate amendment No. 4 with an amendment which is a substitute for the Senate amendment.

Depletion rates for certain clays

Subsection (a) of new section 302 added to the bill under the conference agreement relates to the depletion rate for certain clays. Subsection (a) makes the same changes in section 613(b) of the 1954 Code as were proposed by the Senate amendment and explained above.

Treatment processes considered as mining

Under the conference agreement, subsection (b) of the new section 302 added to the bill relates to treatment processes considered as mining.

Paragraph (1) amends paragraph (2) of section 613(c) of the 1954 Code to provide that the term "mining" includes not merely the extraction of the ores or minerals from the ground but also the "treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto)" and (within the same limits as provided by

existing law) transportation to the plants or mills in which the treatment processes are applied. As under the Senate amendments, the phrase "ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable product or products" is deleted under the conference agreement.

Paragraph (2) of section 302(b) added to the bill under the conference agreement strikes out paragraph (4) of section 613(c) of the 1954 Code and inserts in lieu thereof new paragraphs (4) and (5).

Specifically included treatment processes.—The new paragraph (4) of section 613(c) describes (in subpars. (A) to (H), inclusive) treatment processes which are to be considered as mining, where applied by the mine owner or operator, to the extent that such processes are applied to the ore or mineral in respect of which the mine owner or operator is entitled to a deduction for depletion under section 611 of the 1954 Code. As under existing law, a described process is to be treated as mining where performed by another person for the mine owner or operator if the mine owner or operator has not disposed of his depletable interest in the ore or mineral to which such process is applied. Under the language of this provision, a described process is not treated as mining where applied to a purchased ore or mineral.

The changes in the text of existing paragraph (4) which are made under the conference agreement are as follows (matter to be omitted is enclosed in black brackets and new matter is printed in italics):

(4) [Ordinary] Treatment Processes Considered As Mining—[The term "ordinary treatment

processes" includes the following:] *The following treatment processes where applied by the mine owner or operator shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under section 611:*

(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

(B) in the case of sulfur recovered by the Frasch process—*cleaning,* pumping to vats, cooling, breaking, and loading for shipment;

(C) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and *ores* or minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, [and sintering] *sintering, and substantially equivalent processes* to bring to shipping grade and form, and loading for shipment;

(D) in the case of lead, zinc, copper, gold, silver, *uranium,* or fluorspar ores, potash, and ores *or minerals* which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including [as an ordinary treatment process] electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore *or the mineral or minerals*

from other material from the mine or other natural deposit; [, including the furnacing of quicksilver ores; and]

(E) the pulverization of talc, the burning of magnesite, [and] the sintering and nodulizing of phosphate [rock] *rock, and the furnacing of quicksilver ores*;

(F) *in the case of calcium carbonates and other minerals when used in making cement—all processes (other than pre-heating of the kiln feed) applied prior to the introduction of the kiln feed into the kiln, but not including any subsequent process*;

(G) *in the case of clay to which paragraph (5)(B) of subsection (b) applies—crushing, grinding, and separating the mineral from waste, but not including any subsequent process; and*

(H) *any other treatment process provided for by regulations prescribed by the Secretary or his delegate which, with respect to the particular ore or mineral, is not inconsistent with the preceding provisions of this paragraph.*

The above material indicates that all of the specifically allowed processes under existing law will continue to be allowed under the bill. In addition, certain other processes are specifically provided for. These include cleaning in the case of sulfur recovered by the Frasch process, and in the case of the minerals and ores coming under subparagraph (C) substantially equivalent processes to those named therein. Under the conference agreement, the treatment processes allowable under existing law with respect to coal and sulfur (recovered

by the Frasch process) are to continue to be allowable. Under subparagraph (C), "sintering" is to be allowed to the same extent as under existing law. Under the amendment uranium is specifically named in subparagraph (D); and the furnacing of quicksilver ores is shifted to subparagraph (E) which contains the specialized processing allowed by present law. In addition, subparagraphs (C) and (D) have been modified so that each relates to minerals or ores otherwise qualifying under such subparagraph.

For calcium carbonates and other minerals when used in making cement, a new subparagraph (F) has been added providing for the allowance of all processing up to the point of the introduction of the kiln feed into the kiln (except for preheating of the kiln feed), but not including any subsequent process. In the case of clay used or sold for use in the manufacture of building and paving brick, drainage and roofing tile, sewer pipe, flowerpots and kindred products, a new list of allowable processes is provided for in the new subparagraph (G). The allowable processes in the case of clay so used or sold for use include crushing, grinding, and separating the mineral from waste, but not any subsequent process. In addition, new subparagraph (H) includes as an allowable process any other treatment process provided for by regulations prescribed by the Secretary of the Treasury or his delegate which, with respect to the particular ore or mineral, is not inconsistent with the preceding provisions of the new paragraph (4).

Specifically excluded treatment processes.—The new paragraph (5) added to section 613(c) of the 1954 Code under the conference agreement provides that un-

less such processes are otherwise provided for in paragraph (4) (or are necessary or incidental to processes so provided for), the following treatment processes shall not be considered as "mining": electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping.

Effective date

Subsection (c) of the new section 302 provides that the amendments made by subsections (a) and (b) of the new section 302 are to apply only with respect to taxable years beginning after December 31, 1960.

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